**DRAFT SUBMISSION FOR AASB CONSIDERATION**

XX October 2008

Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
UNITED KINGDOM

Dear David

## Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity*

The Australian Accounting Standards Board (AASB) is pleased to provide comments on the abovenamed Discussion Paper. In forming its views on the Discussion Paper, the AASB held a Roundtable with constituents and considered comments it received in response to its Invitation to Comment on the Discussion Paper.

The AASB generally supports the proposed concepts for private sector businesses. It also supports a notion of a reporting entity that is broader than a legal entity and particularly supports the group reporting entity perspective in preparing consolidated financial statements.

The AASB's comments on specific aspects of those proposed concepts are in the attached submission.

**Primary comments about proposals**

The AASB's primary comments are:

(a) The revised Framework should clarify that the 'benefits' element of the working definition of control would cover forms other than cash flows, and that the details of the alternative forms of benefits is a matter to be dealt with at the standards level.

(b) The determination of the boundaries of a reporting entity under the common control model should further be addressed.

**Implications for not-for-profit entities**

The Appendix to the submission provides the AASB's comments on potential implications of the proposed concepts for not-for-profit entities. These comments are principally provided for Phase G of the Framework project. In addition, the AASB considers it might be useful for the IASB and FASB to be aware of these implications, especially to identify opportunities to use concepts and terminology that are sufficiently broad to apply to private sector businesses and other types of entity, as noted below.

**Suggestion for using more neutral expression**

Because the AASB is responsible for developing a conceptual framework applicable to all Australian reporting entities, regardless of the sector in which those entities operate, its approach has been to add to the IASB *Framework* text for entities not addressed by that *Framework*, but only to the extent necessary. It would assist the AASB and other national standard setters adopting the IASB *Framework* if the expressions used in the revised IASB *Framework* were as sector-neutral as possible.

If you have queries regarding any matters in this submission, please contact Ahmad Hamidi (ahamidi@aasb.gov.au) or me.

Yours sincerely

David Boymal
Chairman

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# Preliminary Views on an improved Conceptual Framework for Financial Reporting: *The Reporting Entity*

## *Specific Comments in Relation to Private Sector Businesses*

## Section 1: The reporting entity concept

### Question 1

**Do you agree that what constitutes a reporting entity should not be limited to business activities that are structured as legal entities? If not, why?**

1. The AASB supports having a notion of a reporting entity that is broader than activities that are structured as legal entities because users may have a need for information about a business that is not defined by legal boundaries.

2. Australia applies the IASB Conceptual Framework with limited modifications for not-for-profit entities. There are entities in the not-for-profit sector about which there is significant interest which may not have a legal status. Not limiting reporting entities to legal entities would be helpful in maintaining this approach when revising the current domestic Framework based on the outcome of the IASB-FASB Conceptual Framework project.

### Question 2

**Do you agree that the conceptual framework should broadly describe (rather than precisely define) a reporting entity as a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers? If not, why? For example, do you believe that the conceptual framework should establish a precise definition of a reporting entity? If so, how would you define the term? Do you disagree with including reference to equity investors, lenders and other capital providers in the description (or definition) of a reporting entity? If so, why?**

3. The AASB agrees that the conceptual framework should broadly describe the reporting entity rather than precisely define it.

4. The AASB notes that the proposed description of a reporting entity relies on the notion of ‘capital provider’. This notion depicts a narrow spectrum of users and should be expanded for the following reasons:

    (a) the notion is market-oriented and of less relevance to developing countries. It may only work well in environments where capital markets are a dominant feature;

    (b) the term ‘capital provider’ does not cover public interest. While it is up to the standard setter in each jurisdiction to assess public interest, it would be appropriate to acknowledge ‘public interest’ in the IASB’s conceptual framework by identifying a broader range of users in the Objectives phase of the conceptual framework project. The definition of a reporting entity would subsequently include a reference to this broader range of users;

    (c) the term ‘business activity’ in the description of a reporting entity should be replaced with a term that is more generic. Throughout the DP, the analysis appears to have been made with only for-profit private entities in mind and this creates ambiguities as to the breadth of activities the term is meant to cover;

(d) the DP does not clarify why ‘business’ is a building block of the proposed reporting entity concept. Although ‘business’ has a specific defined meaning in IFRS 3, this might not have been the intended meaning at a conceptual level. The term ‘business’ can have different connotations in different contexts and may need to be defined or clarified. For example, some note, it is not clear whether Special Purpose Entities (SPEs) would constitute businesses; and

(e) paragraph 26 of the DP notes that some might have concerns about specifically referring to ‘capital providers’ in the description of a reporting entity since it may imply that the existence of the circumscribed area of business activity depends on there being capital providers who have an interest in the business. Although we do not have the concern noted, the DP’s argument that the business exists irrespective of there being capital providers who have an interest seems unconvincing.

# Section 2: Group reporting entity

## Question 3

**Do you agree that the risks and rewards model does not provide a conceptually robust basis for determining the composition of a group reporting entity and that, except to the extent that it overlaps with the controlling entity model (as discussed in paragraphs 102 and 103), the risks and rewards model should not be considered further in the reporting entity phase of the conceptual framework project? If not, why?**

5. The AASB believes that the risks and rewards model as described in the DP would generally not, of itself, provide a robust basis for determining the boundaries of a group reporting entity. However, a risks and rewards analysis may be useful at the standards level to assist in determining who controls an entity.

6. Using ‘risks and rewards’ as the concept for determining the boundaries of a group reporting entity is conceptually distinct from using ‘control’ for that purpose. In particular, a risks and rewards model does not include a power criterion. Under an approach that relies only on risks and rewards, the boundaries of the group reporting entity may include entities over which there is no power to direct financing and operating policies. Under a control approach, no limit is set on the extent of benefits to be received, which contrasts with the risks and rewards approach that commonly refers to “majority” of benefits.

## Question 4

**Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that:**

**(a) control should be defined at the conceptual level?**

**(b) the definition of control should refer to both power and benefits?**

7. The AASB is of the view that the concept of control as the basis for determining the boundaries of the group reporting entity should be defined at the conceptual level. The

AASB agrees, in principle, with the working definition of control proposed in the DP. Standards level clarifications and commentary would be needed to facilitate its application.

8. It would be helpful if the basis for the wording of the definition of control could be more fully articulated. For example, it would be helpful to explain why the definition refers to ‘increasing’, ‘maintaining’ or ‘protecting’ the amount of benefits and reducing the amount of losses and to know what would be the implications of not including these references.

9. The AASB agrees with the definition of control to include a reference to both power and benefits. However, the DP has not dealt with the benefit criterion in sufficient detail compared with the power criterion. Some benefits are in forms other than cash flows. For example in a stapled securities arrangement where one of the entities is designated as the parent, benefits are represented by the ability to operate jointly rather than cash. The DP uses the phrase ‘cash flows and other benefits’ (paragraphs 68, 92 and 127) but does not elaborate on the meaning of other benefits. It is therefore desirable that the revised Framework clarifies with greater prominence that the benefits notion covers forms other than cash flows.

## Question 5

**Do you agree that the composition of a group reporting entity should be based on control? If not, why? For example, if you consider that another basis should be used, which basis do you propose and why?**

10. The AASB believes that the default basis for determining the composition of a group reporting entity should be control. However as noted in relation to Question 3, there are occasions when a consideration of risks and rewards at the standards level may help in determining where control resides.

11. Paragraph 78 of the DP refers to it being “unusual to have a majority stake”. It is not clear to the AASB whether the reference to stake is a reference to only ownership. If it is, then the DP inappropriately argues in favour of majority ownership being the primary conceptual criterion for determining whether to include an entity in a group reporting entity—although the AASB notes that this may not have been the intended meaning.

## Question 6

**Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that the controlling entity model should be used as the primary basis for determining the composition of a group entity?
If not, why?**

12. The AASB believes that the controlling entity model should be used as the primary basis for determining the composition of a group reporting entity.

## Question 7

**Do you agree that the common control model should be used in some circumstances only? If not, why? For example, would you limit the composition of a group reporting entity to the controlling entity model only? Or would you widen the use of the common control model? If you support the use of the common control model, at least in some circumstances, do you regard it as an exception to (or substitute for) the controlling entity model in those circumstances, or is it a distinct approach in its own right? Please provide reasons for your responses.**

13. The AASB believes that 'control' should be the centrepiece of the model for determining the boundaries of an entity that reports. The AASB also notes that in some circumstances it is not clear that control is achieved through a parent. There are group structures in Australia where a common control model could usefully be adopted. Dual listed company arrangements[1] and stapled securities arrangements are examples of such structures[2]. Currently, in Australia, the composition of the group reporting entity in such cases is determined using what some regard as an extended interpretation of a controlling entity model where the controlling entity is regarded as an imputed entity such as a body of common shareholders, or one of the entities in the stapling arrangement is designated as the parent.

14. Sometimes a private sector not-for-profit entity and a for-profit entity may be linked such that a parent cannot be identified, particularly where the costs of the not-for-profit entity are borne by the for-profit entity.

15. In circumstances where a common control model is applicable, the AASB considers the common control model as a substitute for the controlling entity model.

# Section 3: Parent entity financial reporting

## Question 8

**Do you agree that consolidated financial statements should be presented from the perspective of the group reporting entity, not from the perspective of the parent company's shareholders? If not, why?**

16. The reasons for adopting a group reporting entity perspective in preparing consolidated financial statements are similar to those applicable to adopting an entity perspective in preparing the financial statements of an individual reporting entity. Consistent with the

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1 Some legal entities listed on the Australian Securities Exchange have entered dual listed company (DLC) arrangements under which activities are managed as a single economic entity under contractual arrangements between two or more companies, while each company retains their separate legal identity. In these cases one entity has not acquired an ownership interest in the other entity and the individual legal entities have not been combined into a new legal entity. The securities of the entities comprising the DLC are normally quoted, traded or transferred independently in different capital markets. The contractual agreements underlying a DLC result in an economic entity in which the shareholders of the contracting companies have a common economic interest, including arrangements to ensure that all shareholders receive equivalent dividends, irrespective of the particular contracting company in which they hold shares.

2 In Australia, some legal entities have issued equity securities that are combined with ('stapled to) the securities issued by another legal entity by virtue of a contractual arrangement between the entities. The securities of each legal entity that form the 'stapled securities' cannot be traded or transferred independently and only the stapled securities have a quoted market price. The stapling of the equity securities of two or more legal entities results in those entities having equity holders in common.

entity perspective used in the Objectives phase of IASB-FASB Conceptual Framework project, the AASB supports the presentation of consolidated financial statements from the perspective of a group reporting entity. The AASB would like to emphasise that the entity perspective has always been the perspective adopted in standard setting in Australia and has been well received in the Australian financial reporting environment.

*Why the entity perspective should be adopted*

17. The entity perspective reflects the interest of a range of stakeholders and not just owners. This is consistent with the community's expectations of financial reporting. More recent developments in financial reporting such as triple bottom-line reporting that are concerned with reporting the impact of an organisation's activities on a range of stakeholders is largely in response to these expectations. It is arguable that the single perspective of the owner is no longer acceptable to the broad range of users who seek increased levels of disclosure about the impact of the entity's activities on various aspects of economic and social life.

18. The general purpose nature of financial statements is consistent with the entity perspective. It is arguable that, with the development of large listed entities where there is a separation between ownership and management, both liabilities and proprietorship items are regarded as sources of capital. From the entity view point, the owners are providers of finance as are lenders and other creditors. The financial statements become a means of communicating financial information by management to external parties such as owners, lenders and suppliers who rely on information in general purpose financial statements.

19. Governments, including regulators, and the public see large entities as separate and distinct from the equityholders with an existence and objective of their own. Accordingly, the broad community view of most large businesses is consistent with an entity perspective.

*Why the proprietary perspective is not helpful*

20. The proprietary perspective may work for partnerships and other forms of business activity that involves the direct participation of equityholders in the entity's management. However, adopting a proprietary perspective in circumstances where activities are performed through large entities with numerous shareholders who are detached from the management and where there are a wide range of users who rely on the financial information for making decisions is not consistent with the objective of general purpose financial reporting.

*Entity perspective in consolidated financial statements*

21. A group reporting entity perspective results in financial statements that recognise the assets, liabilities, income and expenses under the control of the parent, and therefore meets the needs of a broader group of users than parent entity equity investors. In addition, a parent entity focus can give rise to inappropriate and irrelevant information in the context of some groups such as with stapled securities arrangements in the Australian environment.

22. The group reporting entity encompasses both the parent and subsidiaries and its financial statements present the results of a single economic entity. Preparing financial statements from the perspective of the parent is inconsistent with this view of a group reporting entity since it draws a distinction between the parent entity and other entities within the group. The economic entity view is consistent with the entity perspective

where outside equity interests are treated no differently from parent entity interests in a subsidiary.

23. The group reporting entity perspective is consistent with the focus on a wide range of users on the grounds that it views the effect of transactions and other events from the perspective of the entire economic entity rather than a constituent part. The AASB believes that the entity perspective would not compromise the information needs of the parent entity equityholders, rather it ensures the provision of information that satisfies the needs of those equityholders as well as other users. Moreover, the adoption of a group reporting entity perspective would not mean that disclosure of information for particular use by parent entity equityholders cannot be devised at the standards level.

## Question 9

**Do you agree that consolidated financial statements provide useful information to equity investors, lenders and other capital providers? If not, why?**

24. We agree that consolidated financial statements that use the concept of control in determining the composition of group reporting entity satisfy the objective of financial reporting, that is providing information to users to enable them to make decisions. This does not, however, mean that in some instances additional information about the parent entity in the form of separate financial statements, or disclosures in consolidated financial statements, is not needed.

## Question 10

**Do you agree that the conceptual framework should not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as consolidated financial statements? If not, why?**

25. The AASB agrees that the conceptual framework should not preclude the presentation of parent entity related information whether in the form of parent-only financial statements or disclosure in the consolidated financial statements. The AASB believes that parent-only financial statements would only provide useful information if they are published in conjunction with consolidated financial statements. This is because parent-only financial statements are not regarded as general purpose financial statements on the grounds that they do not recognise the assets, liabilities, income and expenses under the control of the parent on a line-by-line basis.

26. Some parent entity information may be needed by stakeholders to assess the liquidity and solvency of the entity in which they have a direct investment. Furthermore, Australian law currently requires dividends to be paid out of the profits of the individual entity and therefore parent-only information would be useful in assessing the entity's ability to pay dividends.

27. The AASB undertook a study of the information needs of the users of parent entity financial statements in 2003. Among other things, the study concluded that parent entity financial statements are more likely to be needed by users when the parent:

    (a) conducts substantive operations, including treasury operations;

    (b) is a borrowing entity;

    (c) singularly guarantees the debt of one or more of the subsidiaries; or

    (d) is unable to gain unfettered to access the cash flows of subsidiaries.

The study recommended that, in the absence of the above circumstances, the consolidated financial report should, among other things, merely disclose:

(a) the parent entity's shareholders' funds, including dividends and related tax credits, if different from the consolidated amounts;

(b) the manner in which the group is structured, including which entity within the group conducts the major trading and treasury operations;

(c) in which entities the group's borrowings and contingent liabilities reside; and

(d) guarantees and indemnities in place, including which entities are party to the guarantees.

28. The AASB notes that there is ambiguity regarding the meaning of the word 'included' in Question 10. For example, a customary way of including parent-only financial statements in the consolidated financial report is by preparing two columns, one reflecting consolidated figures and the other column showing parent-only figures. The DP should clarify that the way the parent-only financial statements are included in the same report as consolidated financial statements will be dealt with at the standards level.

# Section 4: Control Issues

## Question 11

**With regard to the concept of control, in the context of one entity having control over another, do you agree that:**

**(a) establishing whether control exists involves assessing all the existing facts and circumstances and, therefore, that there are no single facts or circumstances that evidence that one entity has control over another entity in all cases, nor should any particular fact or circumstances—such as ownership of a majority voting interest—be a necessary condition for control to exist? If not, why?**

29. The AASB believes that whether an entity has control of another entity will always be a question to be decided in the light of the prevailing circumstances. The determination of the existence of control will entail the exercise of professional skill and judgement by the preparer (and auditor) of the financial report with a view to representing the situation faithfully. Faithful representation may entail additional disclosures about the application of judgement. Accordingly, the AASB agrees that there is no single fact or circumstance that evidences that one entity controls another entity in all cases nor should any particular fact or circumstance act as a necessary condition for the existence of control.

30. The AASB believes, however, that the clarification of this principle is a standards level issue since it would need to be complemented by detailed analysis of some of the facts and circumstances encountered in practice.

**(b) the concept of control should include situations in which control exists but might be temporary? If not, why?**

31. The AASB believes that during the time that control is held and until such time as control ceases, the subsidiary is part of the group reporting entity and needs to be reflected in the consolidated financial statements. Accordingly, the AASB agrees that the concept of control should include temporary control.

32. There may be a need to address practical issues that arise from temporary control at a standards level. For example, there are issues that may need to be addressed in relation to parent entities that are investment vehicles and which regularly buy and sell interests in controlled entities.

**(c) the control concept should not be limited to circumstances in which the entity has sufficient voting rights or other legal rights to direct the financing and operating policies of another entity, but rather should be a broad concept that encompasses economically similar circumstances? If not, why?**

33. The AASB agrees with the statement. For example, it may be possible to control the voting rights of another entity without holding a majority interest in the voting rights. This would happen where, in the absence of another entity dominating the composition of the board of directors, voting rights held by one entity, while less than 50 per cent, constitute a majority of those voting rights that can be exercised in a coordinated manner.

**(d) in the absence of other facts and circumstances, the fact that an entity holds enough options over voting rights that, if and when exercised, would place it in control over another entity is not sufficient, in itself, to establish that the entity currently controls that other entity? If not, why?**

34. The AASB agrees with the statement.

**(e) to satisfy the power element of the definition of control, power must be held by one entity only? In other words, do you agree that the power element is not satisfied if an entity must obtain the agreement of others to direct the financing and operating policies of another entity? If not, why?**

35. The AASB agrees. A significant feature of control is that the controlling entity's power to direct is not shared with others. The capacity to act, which is at the core of the power element, cannot be shared or divided. An entity lacks this capacity and therefore power if it needs the agreement of other parties to act.

**(f) having 'significant influence' over another entity's financing and operating policy decisions is not sufficient to establish the existence of control of that other entity? If not, why?**

36. The AASB agrees that significant influence is not sufficient to establish the existence of control. When there is significant influence, the investor controls the asset it holds, being its equity interest in the investee, but it does not control the individual underlying assets and liabilities of the investee, nor any proportion of them.

## Question 12

**Should any of the above control issues be addressed at the standards-level rather than at the concepts level? If so, which issues and why?**

37. The AASB believes that issues of 'principle' should be discussed at the concepts level and the interpretation or clarification of those principles when applied to practical situations should be relegated to the standards level. Accordingly, issues covered by paragraph 141(a), (b) and (d), that is 'determining when one entity has control over another', 'control other than by legal rights, and 'power is not shared with others' should be discussed at the concepts level. Issues noted in paragraph 141(e), that is

‘control, joint control, and significant influence’ have traditionally been discussed at the standards level. While it would be appropriate to discuss control and joint control at the concepts level, it is arguable that ‘significant influence’ may not be appropriate for a conceptual analysis. Initial consideration of the issue by G4+1 group of standard setters in 2001 points to the difficulty of defining the term unambiguously. Interpretation of the capacity to exercise control is a standards level issue and issues under paragraph 141(c), that is ‘latent control and treatment of options’ would fall into this category.

## Question 13

**Are there any other conceptual issues, relating either to the control concept or to some other aspect of the reporting entity concept, that are not addressed in this discussion paper and should be addressed at the concepts level? If so, which issues and why?**

38. The issue of control where there is less than a majority interest (either in capital or voting rights) needs to be clarified.

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## Suggestions for Editorial Amendments

| **Paragraph** | **Comment** |
|---|---|
| 24 | In the second sentence, the title of the exposure draft for the first phase of the project should include ‘Financial Reporting’ before ‘Information’. |
| 104 | References to ‘drawing bright lines’ may need to be replaced with other more appropriate expressions, because that expression is colloquial and is in common usage only in a limited number of countries, and its meaning may be difficult to appreciate without having seen it used in particular contexts. |
| 106(a), 118 | In paragraph 106(a) and the following discussion, it is not clear why ‘parent company approach’ was used instead of ‘parent entity approach’. A consequence of using ‘company’ is that in paragraph 118 (second sentence) and subsequently, references are made to “shareholders” rather than to holders of equity interests or ‘owners’ (and thereby may be interpreted as inappropriately excluding unit holders and the like). The section’s heading is ‘parent entity financial reporting’. |
| 106(b) | There is an overlap between “which sets” in the second line and “whether both sets” in the last line. The AASB suggests amending the sub-paragraph as follows: “… determining which ~~set of~~ of those sets of financial statements (which may be either or both) meets the objective of general purpose financial reporting.” |
| 107 | Reading the penultimate sentence was found to be difficult because it refers to the parent company approach vis-à-vis the proprietary perspective and entity perspective without first describing what the parent company approach is. |
| 109 | In the last sentence, the AASB thinks “claims on those resources (eg *its* liabilities and equity interests)” should be “claims on those resources (**ie** *its* liabilities and equity interests)” and “that change the entity’s resources and claims on them (eg. *its* revenues and expenses)” should be “that change the entity’s resources and claims on them (**ie** *its* revenues and expenses)” [difference highlighted in bold print]. |

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| **Paragraph** | **Comment** |
|---|---|
| 147(a) | The AASB thinks that subparagraph 147(a) should be amended as follows: “there is no single fact~~s~~ or circumstance~~s~~ that evidences that one entity has control over another entity in all cases, nor should any particular fact or circumstance~~s~~–such as ownership of a majority voting interest–be regarded as a necessary condition for control to exist”. |
| 28, 120, and 134 compared with 137 | References to ‘disregarding boundaries’ between legal entities in paragraphs 28 and 120 and the reference to “providing information about all assets, liabilities and activities under the parent entity control” in the second sentence of paragraph 134 appear to be inconsistent with the message in paragraph 137 that the way information is presented in consolidated financial statements raises issues that relate to other phases of the Conceptual Framework project and would be addressed at the standards level. The AASB suggests that the revised framework avoids this apparent inconsistency. |

> ***Note to the AASB:***
>
> Staff suggest that this Appendix focus on private sector rather than public sector not-for-profit issues so that our message is not diluted and dismissed as outside the charter of the IASB.

# Appendix

## AASB's Comments on Implications of the Proposed Concepts if They Were Applied to Not-For-Profit Entities

## The reporting entity concept

A1. It is important in the context of the not-for-profit sector that the reporting entity can be an entity that is not a legal entity. In the not-for-profit sector, there may be organisations with distinct existence that might lack legal status but in respect of which there are users who are interested in their activities and to whom their management should be accountable. A limitation on reporting entities being legal entities would be particularly inappropriate in the not-for-profit sector where entities about which there is significant user interest and demand for accountability may not have a legal status.

A2. If the term 'business activity' is perceived as having a for-profit connotation, it may not be suitable in a not-for-profit context. The AASB agrees with the Monitoring Group's[3] view that it would be appropriate to consider using a term other than 'business activity' that could be applied in both a for-profit and a not-for-profit context.

A3. Not-for-profit entities have potentially a different and wider user group than the entities in the for-profit sector. They comprise resource providers, recipients of goods and services, parties performing a review or oversight function and management and governing bodies. Accordingly, the AASB agrees with the comments of the Monitoring Group that the DP's focus on capital providers as users of financial reports in its description of a reporting entity is too narrow for application in the not-for-profit sector. The AASB agrees with the Monitoring Group's view that funders and financial supporters should also be identified as capital providers and that the recipients of goods and services and members of not-for-profit entities should also be considered primary user groups for not-for-profit entities and the description or definition of a reporting entity should be amended accordingly.

A4. The AASB also supports the Monitoring Group's account of some other reporting entity issues that may arise in the not-for-profit sector, in particular whether and in which circumstances branches or other sub-entities of a not-for-profit entity constitute reporting entities. An example may be when fundraising occurs at a branch level and

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3 The Group consists of Chairs and senior staff members of standard-setting bodies in Australia, Canada, New Zealand and the United Kingdom. The group has been monitoring the development of the IASB-FASB joint conceptual framework project from the perspective of private and public sector not-for-profit entities. It comments on the applicability to not-for-profit entities in the private and public sectors of the concepts proposed in the DP can be reached on the AASB website at www.aasb.gov.au.

where user decisions are made and the discharge of accountability is appropriate at that sub-entity level.

## Group reporting entity

A5. As noted in the attached submission, the DP has not dealt with the benefit criterion in sufficient detail compared with the power criterion. There is a need for a broader notion of benefits than cash flows particularly in the not-for-profit sector. In a not-for-profit context benefits could flow in the form of satisfying the objectives of the controlling entity, in the form of delivery of goods or services to the controlling entity or to beneficiaries on behalf of the controlling entity. A controlling entity may derive both financial and/or non-financial benefits from a controlled entity.

A6. Under the proprietary perspective, the assumption is that the entity is an instrument of equity investors to increase their wealth. Such an assumption does not necessarily hold in the case of not-for-profit entities where the measurement of profit from the owners' perspective is not the underlying objective of financial reporting. Accordingly, adoption of a proprietary perspective would be problematic for jurisdictions such as Australia where the same concepts, principles and rules are intended to be used for both the for-profit and not for-profit entities under a sector-neutral policy.

## Control issues

A7. The AASB concurs with the Monitoring Group's view that, in the context of not-for-profit entities, the application of control (as defined to date by standard-setting bodies) has sometimes been difficult and the proposed definition should be assessed against the range of circumstances that arise in the not-for-profit sector to determine whether the definition is appropriate and whether additional commentary could be developed to assist in standards-level decisions. As noted above, the benefit criterion would need to be expanded, particularly in the context of the not-for-profit sector, to encompass benefits that are not in a cash flow form.

A8. The DP could usefully address the relationship between regulation and control. Some of a government's legislative powers establish the regulatory framework within which entities operate. It is generally accepted that such regulatory power does not constitute control possessed by the government or a government-controlled entity over the assets deployed by these entities. For example, although a government authority may have the power to close down the operations of entities that do not comply with emission control regulations, this power does not constitute control by that authority because it only has a regulatory power.

A9. The ability of governments to change legislation raises the question of whether governments possess the capacity to direct the financing and operating policies of a wide range of private sector entities such as charities, other not-for-profit entities and even private sector for-profit entities. Presently, it is widely held that the 'currently exercisable control' should be the principle adopted and therefore the capacity of governments to legislate to control certain private sector entities or expropriation of certain assets does not amount to control. This view is consistent with the general conclusion in paragraph 155 of the DP that when an option holder holds sufficient options that, if exercised, would place it in control of another entity, that is not sufficient, in itself, to establish that the option holder has present control over that other entity.

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A10. In some situations an entity is economically dependent on another entity but retains discretion as to whether it will take funding from, or do business with, the entity. In this case, the first entity has the ultimate power to govern its own financing or operating policies, and accordingly is not controlled by the other entity. An example is where an entity can influence the financing and operating policies of another entity that is engaged in charitable activities because the charity is dependent on it for funding. Here, in the absence of other circumstances, the agreement to provide funding would not, in itself, constitute control by the funding entity.

A11. Not-for-profit entities in the private sector are generally characterised by the absence of defined ownership interests that can be sold, transferred or redeemed or that convey an entitlement to a share of a residual distribution of resources, including on liquidation of the entity. In assessing control relationships, further consideration may be necessary of issues that arise as a consequence of this characteristic.